SUMMARY
of
COOPERATIVE CASES

FARMER COOPERATIVE SERVICE
U. S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D. C.

SUMMARY NO. 64 JULY 1955

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The comments on cases reviewed herein represent the personal opinion of the author and not necessarily the official views of the Department of Agriculture.

INCOME MAY BE "REALIZED" THOUGH "NOT RECEIVED".
(Brown v. Com. of Int. Revenue, 220 F. 2d 12)

Lawyers and accountants struggling with the confusing situation created by the decisions on the taxability of patrons of cooperatives may see a strong, analogous general principle in this decision by the United States Court of Appeals (7th Circuit).

The decision holds that funds contractually due a cash basis taxpayer which are applied to the discharge of such taxpayer's reciprocal contractual obligation to his obligor constitute income realized by the taxpayer when so applied. True, the factual situation involved a landlord taxpayer who had a special contract arrangement with her lessee. But the court goes on the general principle that - "Under a variety of circumstances it has been held that income may be realized even though it is not received by the taxpayer". Accordingly, it concludes that where the taxpayer lessor had agreed with her lessee to contribute to improvements and remodeling done by lessee by allowing the lessee a credit against the rental due under the lease, the taxpayer received taxable income in those years in which the lessee took the credits in accordance with the lease. Although there had been contingencies as to the credit, the court found that these were met during the taxable years in which lessee claimed the credits. The court said that "when those conditions were met, as they were, this part of the obligation became definite and certain."

If this decision is sound, why doesn't a cooperative patron "realize" income in a case where patronage refunds to which he is entitled by contract are by contract with his cooperative invested in capital obligations of the cooperative?

It is also interesting to note that the "consistency" argument of the Commissioner won out in this case, although rebuffed in Carpenter (see Tax Court opinion in Summary No. 57, p. 5). The court, as a concluding argument, pointed out that the lessee had claimed the credits as rent in the years in question and: "By the same token, such payments were properly charged to the taxpayer as income."

Because of the interesting possibilities which this case seems to offer as an analogy to the cooperative-patron contract situations, the following excerpts from the opinion are quoted below:

> "A decision of the issue in dispute depends upon the effect to be given provisions contained in Section 22(a) and (b) [of the lease]. For a better understanding of those provisions, however, it appears pertinent to note that the lease provided for a fixed rental of $40,000 per year, plus a percentage rental based upon gross sales made by the lessee. ... The lessee was authorized under its exclusive control and supervision to alter and remodel the premises demised. Section 22 of the lease provides, so far as material, as follows:
>
> > "'Lessor agrees to contribute towards the remodeling, altering and air-conditioning the sum of Sixty-Five Thousand Dollars ($65,000.00), to be paid and/or credited by the Lessor, as follows:
> >
> > "(a) Thirty-Two Thousand Five Hundred Dollars ($32,500.00) shall be paid by the Lessor as such remodeling, altering and air-conditioning progresses, to Lessee's general or sub-contractors * * *.
> >
> > "'(b) Thirty-Two Thousand Five Hundred Dollars ($32,500.00) to be credited to the Lessee from the rental due and owing by it under this Lease, if and after the Lessor has received a minimum of Fifty Thousand Dollars ($50,000.00) as rent for the demised premises in any one year of the tenancy herein created, and until such deductions aggregate Thirty-Two Thousand Five Hundred Dollars ($32,500.00). * *'"
>
> "Section 23 provides that in the event the cost of the improvements "exceeds the sum of Sixty-Five Thousand Dollars ($65,000), such excess is to be paid and borne exclusively by Lessee,"' and if it costs less than $65,000, "the Lessor shall be required to pay only the actual cost thereof and the credits provided in 22(b) hereof shall abate accordingly."' Section 24 provides that all work of "a non-permanent character is to be paid for by the tenant and is not to be included in said sum of Sixty-Five Thousand Dollars ($65,000.00) herein allowed by Lessor to Lessee for remodeling, repairing and air-conditioning."'

"In summary, lessor assumed an obligation to expend $65,000 for the remodeling of the demised premises, one-half of which was to be paid directly by her, which obligation was discharged and is not here involved. The other one-half was conditioned upon the requirements contained in Section 22(b). Such requirements were met and what had theretofore been a conditional obligation of the lessor became fixed and was discharged in the manner provided in Section 22(b), that is, by a credit to the lessee "from the rental due and owing by it under this lease."

"As shown by the stipulated facts, the total rental for the year 1948 was $70,528.72 of which $40,000 was the fixed and $30,528.72, the percentage. For the year 1949, the total was $62,318.13, of which $40,000 was the fixed and $22,318.13, the percentage. Under paragraph (b), the taxpayer was entitled to and did receive a minimum rental of $50,000 each year. (This included the $40,000 fixed and $10,000 from the percentage rental.) After such payments, there remained in the hands of the lessee, of the percentage rental, the sum of $20,528.72 for the year 1948, and $12,318.13 for the year 1949, which amounts under paragraph (b) were "due and owing" to the taxpayer but which by the terms of the lease the lessee was entitled to pay on improvements and take credit therefor. The lessee took credit for $20,528.72 in the year 1948, and $11,971.28 in the year 1949. The cost of improvements was $79,372.53, $32,500 of which was paid directly by the lessor in accordance with the provisions of paragraph (a). The lessee received credit for rental due the taxpayer in a like amount during the years 1948 and 1949. The balance of the cost of improvements, that is, the sum of $14,372.53, was under the terms of the lease the debt of the lessee, which it paid. The net result flowing from paragraph (b) is aptly stated in the stipulation as follows:

"With respect to said $32,500 credited to Morris B. Sachs, Inc., $20,528.72 thereof was credited on total rental of $70,528.72 for 1948 thereby reducing the cash payment of rental by $20,528.72, and $11,971.28 thereof was credited on total rental of $62,318.13 for 1949 thereby reducing the cash payment of rental by $11,971.28.'"

"Taxpayer employed the cash basis method for reporting income for the years 1948 and 1949. She reported as income $50,000 for the year 1948 ($40,000 fixed plus $10,000 percentage rental), and she reported as income $50,346.85 for the year 1949 ($40,000 fixed plus $10,346.85 percentage rental). She did not report the amounts of $20,528.72 and $11,971.28 for the years 1948 and 1949, respectively. (As shown these amounts were, as provided in paragraph (b), "credited to the lessee from the rental due and owing by it" under the lease.)

" [1] The question for decision is whether such amounts represented income to the taxpayer. She contends that they did not inasmuch as they were not received by her. On the other hand, the Commissioner contends, supported by the decision of the Tax Court, that such amounts constituted income of the taxpayer. ...

"We think that by the clear unambiguous language of the lease the taxpayer assumed an obligation to contribute $65,000 toward the cost of improvements. It is true, as heretofore noted, that half of this obligation was conditional but when those conditions were met, as they were, this part of the obligation became definite and certain. And under the express language of the lease the amounts which were paid by the lessee (those upon which the deficiency has been assessed) were in discharge of the lessor's obligation. They were, in the language of the lease, "credited to the Lessee from the rental due and owing by it under this Lease." Further, the lease negatives any idea that the amounts in controversy were paid or considered as obligations of the lessee. The lessee's obligation was expressly limited to an amount spent in excess of $65,000 for permanent improvements and the cost of non-permanent improvements.

" [2] Under a variety of circumstances it has been held that income may be realized even though it is not received by the taxpayer. Helvering v. Horst, 311 U.S. 112, 61 S.Ct. 144, 85 L.Ed. 75; Old Colony Trust Company v. Commissioner, 279 U.S. 716, 49 S.Ct. 499, 73 L.Ed. 918; Lucas v. Earl, 281 U.S. 111, 50 S.Ct. 241, 74 L.Ed. 731; Douglas v. Willcuts, 296 U.S. 1, 56 S.Ct. 59, 80 L.Ed. 3; United States v. Hendler, 303 U.S.564, 58 S.Ct. 655, 82 L.Ed. 1018; United States v. Joliet & Chicago Railroad Co., 315 U.S. 44, 62 S.Ct. 442, 86 L.Ed. 658. True, these cases and no other of which we are aware have considered a factual situation such as is here presented. They are pertinent, however, because of the reasoning and general principle announced. ...

"Another facet of taxpayer's contention is that the improvements made by the lessee were entirely for its benefit and that she received no economic gain. It is pointed out that the evidence shows that the improvements will have no residual value to the lessor at the termination of the lease. Assuming that such is the situation, it does not follow, in our view, that no economic gain inured to the taxpayer, and it would appear that the cost of the improvements was for the mutual benefit of the parties. Undoubtedly lessee's business judgment dictated that the improvements were essential to the success of its business venture. The better it was equipped to serve the public, the more customers it could expect, with a resultant increase in the volume of its business. This was also of vital concern to the taxpayer because the amount of taxpayer's percentage rental depended upon the volume of business done by the lessee. And it is reasonable to think that the same economic motive which moved the taxpayer to contribute $32,500 under clause 22(a) of the lease, induced her to assume a further liability in the same amount under 22(b), to be paid from the percentage rental when it reached a certain amount. As shown, the contingencies were all met during the taxable years in question and the amounts in dispute were paid by the lessee from rent "due and owing" to the taxpayer, which in the absence of agreement would have been paid directly to her, as was other percentage rental to which she was entitled under the terms of the lease.

" In conclusion, it is perhaps of some pertinency to note that the lessee in its income tax returns for the years in question treated the amounts in dispute as rent paid by it to the taxpayer, as it did other rentals paid directly to her. We think that lessee, under the terms of the lease, was entitled to so treat such payments. By the same token, such payments were properly charged to the taxpayer as income."

NATIONAL CRANBERRY ASSOCIATION CHARGED IN NEW ANTITRUST ACTIONS

National Cranberry Association (hereafter called NCA), A. D. Makepeace Co., (one of NCA's largest members), United Cape Cod Cranberry Co., (also a large member of NCA), Marcus L. Urann (President and General Manager of NCA), and John C. Makepeace (Secretary and Treasurer of NCA), were indicted on April 12, 1955, in the United States District Court for the District of Massachusetts for violation of sections 1 and 2 of the Sherman Act (15 U.S.C. 1 and 2). Hyannis Trust Co., Stokely-Van Camp, Inc., Barish and Mickelson, Eatmor Cranberries, Inc., and four local members of Eatmor were all named as co-conspirators. Cranberry Growers Council, Inc., (which operated from 1949 to 1954 but was dissolved in June, 1954) was also named as a co-conspirator.

On May 10, 1955 the United States also filed a civil action against the same five defendants, and the complaint in this action is substantially the same in its allegations as the charges in the criminal action.

The criminal complaint first outlines the nature of the cranberry business, detailing how the berries are produced, how some are marketed fresh and how approximately 60 percent of the annual crop is used in manufactured cranberry products. It states that NCA handles approximately 85 percent of the processed products business.

The complaint then sets forth the following charges of "Combination and Conspiracy In Restraint of Trade."

> "20. Beginning in or about 1945, the exact date being to the Grand Jurors unknown, and continuing thereafter up to andincluding the date of the return of this indictment, the defendants, the co-conspirators herein named, and others to the Grand Jurors unknown, have engaged in a combination and conspiracy to suppress and eliminate competition in the manufacture, sale, and distribution of cranberry products, in unreasonable restraint of the aforesaid trade and commerce in cranberry products among the several States of the United States in violation of Section 1 of the Act of Congress of July 2, 1890, c. 647, 26 Stat. 209, as amended, commonly known as the Sherman Act.

"21. The aforesaid combination and conspiracy has consisted of a continuing agreement and concert of action among the defendants, the co-conspirators named herein, and others to the Grand Jurors unknown, the substantial terms of which have been and are that they agree to:

"(a) induce and compel independent growers, other cooperatives and independent shippers of cranberries to sell solely to NCA all cranberries to be used in the manufacture of cranberry products.

"(b) limit and confine the manufacture of cranberry products solely to NCA;

"(c) suppress, prevent, eliminate, and exclude competition from independent manufacturers and from other cooperatives in the manufacture and sale of cranberry products;

"(d) control and regulate the prices and terms of sale for cranberry products.

"22. In formulating and effectuating the aforesaid unlawful combination and conspiracy, defendants have entered into various agreements, understandings, and arrangements among themselves and with other companies and persons, and have done various things and have performed various acts, including, among others, the following:

"(a) Between 1946 and 1949, the defendants and the co-conspirator Hyannis Trust Co. bankrupted Cape Cod Food Products, Inc., and excluded it from the business of manufacturing and distributing cranberry products.

"(b) From time to time during the period covered by this indictment, the defendants induced and attempted to induce independent manufacturers, including co-conspirator Stokely-Van Camp, Inc., to refrain from engaging in manufacturing cranberry products for themselves or others than NCA.

"(c) From time to time during the period covered by this indictment, the defendants acquired and attempted to acquire for the defendant NCA substantial quantities of cranberries in order to prevent such cranberries from being manufactured into cranberry products by others.

"(d) During part of the period covered by this indictment, the defendants caused the price of cranberries required by independent manufacturers of cranberry products to become and remain artificially high for the purpose of rendering the operations of such independent manufacturers unprofitable and thereby eliminating their competition.

"(e) From time to time during the period covered by this indictment, the defendants unreasonably reduced prices on selected cranberry products in order to eliminate competition from independent manufacturers.

"(f) From time to time during the period covered by this indictment, the defendants adopted and followed a sales policy on cranberry products of defendant NCA which included a scheme of undisclosed rebates to its customers for the purpose of obscuring its final selling prices from independent manufacturers of cranberry products.

"(g) In or about 1949, the defendants induced and persuaded co-conspirator Eatmor and the cooperatives for which it acted as marketing agent to join in the formation of and to become members of the co-conspirator Council, and, acting in part through the said Council, induced and persuaded Eatmor and the said other cooperatives to become parties to agreements, during the years 1950 to 1953, inclusive, which prohibited the delivery and sale of cranberries to any manufacturer of cranberry products other than the defendant NCA, and prohibited the manufacture and sale of cranberry products by any party to the agreements other than the defendant NCA.

"(h) In 1954, the defendants sought to destroy Eatmor by, among other things, inducing growers to deliver all their cranberries to defendant NCA and to refuse to supply cranberries to Eatmor, acquiring all the physical assets of the largest cooperative member of Eatmor, attempting to hire and hiring away Eatmor's employees, attempting to establish and establishing exclusive relationships with brokers who handled Eatmor's products, and attempting to foreclose and foreclosing Eatmor from independent packing facilities.

"(i) During the year 1950, the defendants, acting in part through the co-conspirator Council, induced, compelled, and policed the destruction of more than 60,000 barrels of cranberries by growers for the purpose of preventing their sale to independent manufacturers of cranberry products.

"(j) The defendants, during 1951 to 1954, utilized the co-conspirator Barish & Mickelson to compete against independent manufacturers of cranberry products at prices controlled by the defendants, giving it a preferential discount and subsidizing it to the full extent of losses incurred by it on particular sales."

The effects of the offense charged are said to be:

"(a) The suppression of competition in the manufacture and distribution of cranberry products;

"(b) The exclusion of independent manufacturers and co-operatives from the business of manufacturing and distributing cranberry products;

"(c) The imposition of arbitrary and non-competitive prices on cranberry products;

"(d) The reduction of the amount of cranberries available for distribution and sale to independent manufacturers of cranberry products;

"(e) The limitation of the amount of cranberry products manufactured and sold in the United States; and

"(f) The narrowing of the market in which cranberry growers, cooperatives, and independent shippers can sell cranberries."

Advisors of cooperative management will no doubt want to watch developments in this situation as possibly establishing antitrust precedents in the application of the antitrust laws to activities of cooperatives. As this publication has frequently emphasized, once a cooperative is organized even in compliance with the requirements of the Capper-Volstead Act, it is as a general proposition just as amenable to the antitrust and fair trade acts as any other type of business enterprise.

NON-EXEMPT CORPORATION HAD ADEQUATE "CONTRACTUAL RELATIONSHIP" WITH MEMBERS TO EXCLUDE PATRONAGE REFUNDS.

(Southwest Hardware Co. v. Commissioner 24 T.C. ____, No. 12, April 26, 1955)

The main issue in this case was whether the patronage refunds paid by this taxpayer were paid under legal obligation according to pre-existing contracts. The court held they were and that they could be excluded in computing taxable income.

The taxpayer was organized in 1912 under the general corporation law of California. It had always carried on its business as a cooperative wholesale dealer in hardware, selling only to its stockholder members, who owned equal amounts of stock.

It was conceded that it was not a tax-exempt corporation under 1939 Code Section 101 and that its members had no right to patronage refunds by reason of a state statute, or the articles of incorporation or by-laws. However, the taxpayer claimed the right to exclude from its gross income the margins upon business done with its members because of the contract it had with them.

No dividends ever had been paid on the stock of the corporation. Moreover, the evidence showed that it was agreed between taxpayer and each prospective stockholder at the time the stock was purchased that all of the taxpayer's annual net margin of receipts over costs and operating expenses would be distributed to the stockholders in proportion to the purchases of each. In each year, patronage refunds were paid to members in certificates representing their proportionate shares and such shares were credited to each member on the taxpayer's books. The certificates were redeemed by the taxpayer in cash during 5 years after issuance.

On these facts the Tax Court held that:

1. the patronage refunds paid in certificates were distributed under legal obligation pursuant to contracts with taxpayer's members;
2. the "net profits" in question never belonged to taxpayer and were not its income;
3. the policy of the directors of making cash refunds to all members at the same time was not in derogation of the member's rights to receive the patronage refunds; and
4. the amounts credited and distributed to shareholder members as outlined above could be excluded from gross income for the taxable years in question in computing the net income subject to tax.

COOPERATIVE NOT SUBJECT TO USUAL RULE RESTRICTING ACTIONS BY SHAREHOLDERS IN RIGHT OF CORPORATION

(Northridge Coop. Section No. 1 v. 32nd Ave. Const. Corp. 136 N.Y.S.2d 737)

This case holds that a cooperative corporation is not subject to the general rule in New York that a shareholder in an action in right of corporation must show that he was a stockholder at the time of the transaction complained of or that his stock thereafter devolved to him by operation of law.

The case also holds that allegations to the effect that purchasers of stock were induced by false representations to believe that carrying charges would be within their capacity to pay, were not objectionable as showing injury only to stockholders and not to corporation. Again, the special character of a "cooperative corporation" was considered.

This was an action by a cooperative corporation to recover "windfall" profits. The case was heard on motion to dismiss, which was denied in all respects. Pertinent comments by the court on the second and first points mentioned above, in that order, were as follows:

> "With respect to the second point, it is not clear, as a matter of pleading at least, that false representations, inducing purchasers of stock in a cooperative corporation to believe that their carrying charges will be within their capacity to pay, damage only the stockholders and not the corporation. Such reasoning overlooks the nature of a cooperative corporation. Such a corporation is not a business corporation in the ordinary contemplation. It is a vehicle for the common ownership of property, in this instance to enable the occupants, the stockholders of the cooperative, to own, manage and operate residential apartments without anyone's profiting therefrom. It must look to its stockholders for its income to pay the common carrying charges. If by these false representations it has stockholders unable, financially, to meet their burdens, the corporation, as well as the stockholder who bought in reliance on the false representations, may well be damaged. ...
>
> "...An attempt is made to show that, when the transactions complained of took place, none of the stockholders of the present cooperative plaintiff were stockholders and that the dominating defendants or those considered as their designees

were the sole stockholders. Invoking Section 61 of the General Corporation Law and the cases of Austin v. Gardiner, 188 Misc. 538, 68 N.Y.S.2d 664; Eisenberg v. Grossman, 275 App.Div. 946, 89 N.Y.S.2d 787; Capitol Wine & Spirit Corp. v. Pokrass, 277 App.Div. 184, 98 N.Y.S.2d 291, affirmed 302 N.Y. 734, 98 N.E.2d 704; and Ripley v. Colwell, 1954, 206 Misc. 46, 129 N.Y.S.2d 578, per Frank J., as authority for the proposition that there may be no litigation of purchased grievances or derivatively on their behalf, the dismissal of the complaint is sought.

"Preliminarily, it is noted that an issue exists as to the dates when stock of the plaintiff was first sold and that sufficient appears in the opposing affidavits to bar granting the relief sought, were the rule of law invoked applicable. This rule is not applicable, however recourse is had again to the cooperative nature of the plaintiff corporation. [sic] It is held that a cooperative corporation, such as plaintiff, is not subject to the rule referred to, at least when the transactions complained of occur in its organizational phase. Plaintiff's organizers and original stockholders differ essentially from the stockholders of general business corporations. Plaintiff was not organized for profit; rather it is "classed as a non-profit corporation", Sec. 3, Cooperative Corporations Law. Its organizers and original stockholders did not control a business corporation, the stock of which was transferable, as stock in such corporations are dealt in, in market places. The rule promulgated by Section 61 is intended to protect business corporations primarily and perhaps, in a proper case, cooperative corporations from those (a) who had no interest in such corporations when certain transactions of doubtful validity occurred; or (b) had no interest when wholely-owned or closely-held stock corporations have transactions unobjectionable because such corporations may, with the consent of their stockholders, dispose of their assets almost as they please (doing no harm to creditors, of course) from vexatious lawsuits brought by those buying stock after the accomplishment of the questioned transactions. The plaintiff cooperative was formed as a vehicle to be used by those who would live in the apartment to be erected, to enable them to manage and operate without profit a commonly-owned residential property. The organizers and original stockholders had no such property interest, through their stockholdings, as would permit manipulations such as would be permissible in a solely-owned or closely-held stock corporation, always assuming no damage to the creditors of such corporations. The organizers and stockholders of cooperative corporations, such as plaintiff, were,

in effect, owners of record, holders of legal title, for those beneficially interested, those buying, in the first instance at least, into the cooperative corporation. Those so beneficially interested and their corporation are not barred in the stated circumstances by the rule relied upon by the moving defendants. To hold otherwise would do violence to the intendment and purpose of Section 213 of the National Housing Act, 12 U.S.C.A. § 1715e. That Act required the formation of a cooperative corporation from whom the tenant-cooperators would purchase stock. The defendants, in their capacity of promoters and sponsors of the plaintiff corporation, organized and engineered the sale of the subscriptions of stock of the plaintiff cooperative corporation. These defendants set in motion the machinery to meet the requirements of Section 213 and those requirements could not be satisfied if persons, other than the occupants of the project, should become the owners of the stock of the cooperative corporation. In acting under this section, all promoters, nominees, stockholders, subscriber stockholders and qualifying stockholders, were agents for the beneficial owners, i. e., the tenant-cooperator-stockholders and the plaintiff corporation. The plaintiff corporation was not organized for the benefit or profit of these defendants nor of the organizers. It was organized exclusively and entirely for the benefit of plaintiff and its ultimate tenant-cooperator-stockholders. These defendants acted as fiduciaries and agents of the plaintiff and its stockholders and are responsible to it and them in equity in the event of the breach of such trust. A court of equity will not shut its eyes to the realities of this transaction and elevate the form thereof over the substance. To elevate the form would do violence to the purpose for which the plaintiff corporation had its being."

RIGHT OF DEBTOR OF ASSIGNOR TO ASSERT COUNTERCLAIM AGAINST ASSIGNEE

(Maryland Cooperative Milk Producers v. Bell, 110 A.2d 661)

Although this case involved a cooperative, the decision is not peculiarly in the field of cooperative law. It involves an interesting point, however, which may come up in the operations of other cooperatives. The specific thing decided is that a debtor can assert against an assignee a counterclaim based on the obligation of his assignor maturing subsequent to the assignment but before notice thereof.

These were the essential facts: Maryland Cooperative Milk Producers, Inc. (hereafter called MCMP) had loaned money to Unger to buy trucks to haul its members' milk. The loan was secured by a chattel mortgage on which MCMP made collections by offsets each month against amounts due for hauling. Unger became financially involved and, on June 1, 1951, made an assignment of his hauling rights (including amounts due him for hauling) to Bell. At the time of this assignment Unger was not in default on payments to MCMP, but had defaulted on the covenant to keep the mortgaged property insured. On June 25, 1951 MCMP was notified of the assignment. On July 16, 1951 MCMP started foreclosure proceedings and on the following day entered on its books the balance due Unger for June hauling as a credit against the mortgage indebtedness. The next day an attachment was laid.

The lower court held against the attachment creditors but held that Bell (who had intervened) was entitled to priority over MCMP on the amounts it owed Unger. The appellate court reversed this judgment, and held that MCMP was entitled to make the offset.

Excerpts from the opinion follow:

"The controlling question in the case, then, is whether a debtor can assert against an assignee a counterclaim based on the obligation of an assignor maturing subsequent to the assignment but before notice thereof. The answer to this question is not dependent upon the form of the action, but would be the same if raised in a suit by the claimant rather than in the attachment case. Nor does it involve the rights of the claimant as against an attaching creditor. We have found no Maryland case directly in point. ...

"It has been held in Pennsylvania that a counterclaim may be allowed even where it matures after the assignment, if the right was inherent in the outstanding obligation. Northwestern Nat. Bank v. Commonwealth, 345 Pa. 192, 27 A.2d 20. A fortiori, it is allowed where the indebtedness has matured. Peoples Pittsburgh Trust Co. v. Commonwealth, 359 Pa. 622, 60 A.2d 53. The Restatement, Contracts, § 167, recognizes a right "to all set-offs and counterclaims of the obligor which would have been available against the obligee had there been no assignment, provided that such defenses and set-offs are based on facts existing at the time of the assignment." In speaking of this section, Williston, Contracts (Rev. Ed.) § 432, p. 1246, the learned author states: "The denial of a right of set-off because either the assigned claim or the cross-claim was not due at the time of the assignment is, however, not consistent with the general principle allowing set-off against the assignee of claims due from the assignor; and there is good authority to support the rule that the only questions should be, (1) did the claim against the assignor exist whether matured or not, before notice of the assignment, and (2) were both claims matured when the set-off was asserted, and this is the rule that the Restatement of Contracts puts forward. * * * Until notice of the assignment, the debtor should be allowed to assume that he is under contract with the assignor whether the assignor's claim or his own is matured or not." See also 2 Williston, Contracts (Rev.Ed.) § 447. Even after notice, Williston takes the view that the debtor may set up failure of the assignor to fulfill his part of an executory contract, payments under which are assigned. 2 Williston, Contracts (Rev.Ed.) § 433, p. 1253.

"In the instant case we think the set-off should prevail. At the time of the assignment Unger was under an obligation to keep up the insurance on the mortgaged property, some of which was actually used by the assignee, and the breach matured the indebtedness before the Cooperative received notice of the assignment. Whatever the situation might be in a suit by Bell on quantum meruit against the Cooperative or its members, the claim here is based on the contract between Unger and the Cooperative, Bell standing in Unger's shoes. If the suit were by Unger, surely the Cooperative could plead a set-off, even though the transactions were separate though related. The potentiality of a default in the mortgage was an existing fact at the time of the assignment of future payments under the contract. The default had occurred when these payments became due. The case falls squarely into the pattern outlined by Williston and the Restatement, and seems in line with the Maryland cases."

RECENT INTERNAL REVENUE SERVICE RULINGS OF INTEREST TO COOPERATIVES

1. Requirements for Exemption Under Section 101(12)(A), 1939 Code. (Rev. Rul. 55-141; I.R.B. 1955-11, 21)

"Where a farmers' marketing and/or purchasing association issues either a certificate of stock representing a patronage dividend or a check representing a dividend payable on its stock, the mailing of either of such instruments to the patron would constitute payment for Federal income tax purposes in the year of issue, and such refunds will be allowed as deductions from gross income where, in the ordinary handling of the mail, delivery cannot be made and the association holds the instrument subject to the claim of the rightful owner.

"The retention by a farmers' marketing and/or purchasing association of each patronage dividend payable in an amount less than one dollar and similar retentions of the cents payable in excess of whole dollar amounts do not constitute inequitable treatment of all patrons to an extent which would jeopardize the exempt status of such association under section 101(12)(A) of the Internal Revenue Code of 1939.

"Advice has been requested whether the mailing by a farmers' marketing and/or purchasing association of a certificate of stock representing a patronage dividend due, or a check representing a dividend due on the association's stock, to the last known address of a patron constitutes payment for Federal income tax purposes, allowable as deductions from gross income, where such instruments are returned by the Post Office Department because of nondelivery and held by the association subject to claim of the rightful owner; also, whether the retention by a farmers' marketing and/or purchasing association of each patronage dividend payable in an amount less than one dollar and similar retentions of the cents payable in excess of whole dollar amounts constitute inequitable treatment of all patrons to an extent which would jeopardize the exempt status of such association under section 101(12)(A) of the Internal Revenue Code of 1939.

"A farmers' marketing and/or purchasing association pays patronage dividends in shares of its capital stock. The certificates are mailed to patrons at their last known addresses and a few of such mailings are returned by postal authorities because of the inability to locate the addressee patrons. The shares are held by the association, subject to claim by the rightful owners until such time as the shares are called for redemption and payment. If the owner is not then

located, the shares are canceled and a credit is made to an appropriate Income Account, as extraneous income to the association in the year of cancellation. Similar treatment is given to nondelivered dividend checks.

"Moreover, in the allocation of patronage refunds all amounts of individual allocations in the amount of less than one dollar, and all cents in excess of even dollars due patrons entitled to more than one dollar, are set aside as a fund to defray the cost of maintaining patronage records and the allocation or distribution of patronage dividends. The aggregate of amounts so retained is subject to Federal income taxes as net proceeds realized which remain undistributed.

"It is held that where either a certificate of stock representing a patronage dividend or a check representing a dividend payable on the capital stock of a farmers' marketing and/or purchasing association is properly prepared and placed in the mail at such time that in the ordinary handling of the mails it would be received by a patron within the period of time prescribed by section 101(12)(B) of the Code for making refunds, such action would constitute the payment of a patronage refund or a dividend on capital stock, allowable as a deduction from gross income even though such stock certificate or dividend check is later returned and held subject to the claim of the patron because the patron cannot be found by the Post Office Department. It is further held that the retention by a farmers' marketing and/or purchasing association of each patronage dividend payable in an amount less than one dollar and similar retentions of the cents payable in excess of whole dollar amounts do not consitute inequitable treatment of all patrons to an extent which would jeopardize the exempt status of such association under section 101(12)(A) of the Internal Revenue Code of 1939."

2. Tax-free reorganization involving merger of profit corporation with newly organized cooperative. (Rev. Rul. 55-305; I.R.B. 1955-21, 30)

"M, an Oregon corporation was engaged in warehouse operations serving farmers for profit. Due to competition of cooperative associations the corporation formed its own cooperative association under Oregon laws and effected a statutory merger by merging M corporation into the cooperative association, the stock in the corporation being exchanged solely for stock in the cooperative. Held, the transaction constituted a nontaxable reorganization under section 112(g)(1)(A), section 112(b)(3) and section 112(b)(4)of the Internal Revenue Code of 1939.

"Advice was requested with respect to the tax consequences for Federal income tax purposes of a consummated reorganization hereinafter described.

"M, an Oregon corporation, was organized for profit by farmers to own and operate a warehouse for farmers. The capital stock consisted of 20 shares of common stock, par value $100 per share. The value of each share of such stock was 120x dollars based upon a pro rata share of the fair value of the net assets. As many of the stockholders of M corporation were members of other cooperative associations and as most of the warehouse facilities in the same area were operated by cooperative associations, it was desired to organize a new cooperative association with a capital structure consisting of 30 shares of common stock, par value $100 per share, and 250 shares of preferred stock, par value $100 per share. Both issues carried dividend rates of 5 percent, the dividends on the preferred being cumulative and any arrearages thereof being payable before any dividends on the common stock or patronage refunds are paid.

"Pursuant to a merger agreement and plan of reorganization, a statutory merger under the laws of the State of Oregon was effected by merging M corporation into a new cooperative association. Under the plan, for each share of capital stock of M, the cooperative issued twelve shares of its capital stock as follows: Each stockholder of the corporation who was a producer of agricultural products upon surrender of stock of the corporation received for the first 1/12 of each such share one share of common stock of the cooperative and one share of preferred stock of the cooperative for each additional 1/12 share of common stock of the corporation. Each stockholder of the corporation, who was not a producer of agricultural products, received for each 1/12 share of common stock of the corporation, one share of preferred stock of the cooperative. Each stockholder of the corporation who was a producer of agricultural products became a member of the cooperative with the right to vote as such a member, upon surrender of stock in the corporation in exchange for stock of the cooperative. Under the plan it was estimated that 80 percent of stockholders of the corporation were engaged in farming or were lessors of farming property and 20 percent were nonproducers of farming property. Therefore, each of the corporation's producer stockholders received at least one share of common stock of the cooperative as a result of the reorganization plan which qualified them as members. The amount of stock required for membership in the cooperative was one share of common stock. Each member had one vote. The holders of 4 shares of the corporation's stock who were nonproducers received 48 shares of preferred stock of the cooperative; and the holders of 16 shares of the corporation's stock who were producers received 176 shares of preferred stock and 16 shares of common stock of the cooperative.

"Section 112 of the Internal Revenue Code provides in part as follows:

(b) EXCHANGES SOLELY IN KIND.--

* * * * * * *

(3) STOCK FOR STOCK ON REORGANIZATION. --No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) SAME--GAIN OF CORPORATION.--No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

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(g) DEFINITION OF REORGANIZATION.--As used in this section ***

(1) The term "reorganization" means *** (A) a statutory merger ***.

"Section 39.112(g)-2 of Regulations 118 states in part that the words "statutory merger" refer to a merger effected in pursuance of the corporation laws of the United States or a State or Territory or the District of Columbia. Section 39.112(g)-1 provides that in effect there must be substantial business reasons or exigencies for the reorganization; there must be continuity of the business enterprise under a modified corporate form; and there must be a continuity of interest on the part of the persons who were the owners of the enterprise prior to the reorganization. In the instant case the conditions with respect to these sections of the Code and the regulations thereunder were fully complied with.

"Accordingly, it is held that the transaction constituted a statutory merger and, therefore, a reorganization under section 112(g)(1)(A) of the Internal Revenue Code. No gain or loss was recognized to M corporation, the cooperative, or the stockholders who exchanged their stock. The undistributed earnings and profits of M corporation are undiminished by the transaction for the purpose of determining the amount of earnings and profits of the cooperative available for distribution as dividends."